

Department of Legislative Services
Maryland General Assembly
2007 Session

FISCAL AND POLICY NOTE
Revised

Senate Bill 396

(Senator Gladden, *et al.*)

Judicial Proceedings

Environmental Matters

Ground Rents - Remedies for Nonpayment of Ground Rent

This bill alters the remedy for nonpayment of ground rent on residential property. The bill abolishes ejectment and provides for the creation of a lien, notwithstanding any provision in a ground lease giving the ground lease holder the right to reenter the property.

The bill does not affect a ground lease holder's right to bring a civil action against the leasehold tenant seeking a money judgment for the amount of the past due ground rent. On or after January 22, 2007, the owner of a fee simple or leasehold estate in residential property may not create a reversionary interest in the property under a ground lease or ground sublease for a term of years renewable forever subject to the payment of periodic ground rent.

The bill applies to residential property used, intended to be used, or authorized to be used for four or fewer dwelling units. The remedies for nonpayment of ground rent established in the bill do not apply to property leased for any other purpose that is not primarily residential.

The bill takes effect July 1, 2007.

Fiscal Summary

State Effect: Changing the nature of the remedy available for failure to pay ground rent should not materially affect the finances or operations of the Judiciary.

Local Effect: Baltimore City could experience a savings on some properties it owns subject to ground rents. Any such savings cannot be accurately predicted but could be significant in the aggregate.

Small Business Effect: Minimal.

Analysis

Bill Summary: If ground rent is unpaid at least six months after its due date, the ground lease holder may obtain a lien in the amount of the ground rent due. The ground lease holder must give written notice to the leasehold tenant against whose property the lien is intended to be imposed and each mortgagee or trustee of the record. The notice is required to include specified information and must be served by certified mail, return receipt requested, or personal delivery. If the ground lease holder is unable to personally serve the leasehold tenant, notice mailed to the leasehold tenant's last known address combined with conspicuous posting of the notice on the property.

A party to whom notice is given, within 45 days after service, may file a complaint (containing specified information) in circuit court to determine whether a lien should be established.

A party filing a complaint may request a hearing at which any party may appear to present evidence. If a complaint is filed, the party seeking to establish the lien has the burden of proof. Before a hearing, the party seeking to establish a lien may supplement any information contained in the required notice by means of an affidavit.

If a complaint is filed, the court is required to review any pleadings and must conduct a hearing if requested. If the court determines that a lien should be established, it must enter an order finding the amount of the ground rent due and imposing a lien on the identified property. The court must enter an order denying the lien if it determines that the lien should not be established. The court may award costs and reasonable expenses and of up to \$500 attorney's fees to a prevailing party.

The amount of the lien is for the amount of the ground rent found due by the court, along with any costs, expenses, and attorney's fees awarded. If a complaint was not filed and the past due ground rent was not paid, the amount of the lien is for the past due ground rent alleged to be due in the notice, along with reasonable expenses and attorney's fees of up to \$150. The lien amount increases by the amount of the ground rent accruing after the statement of lien is filed in the land records plus simple interest at the legal rate accruing from the filing date.

The ground lease holder may file a lien statement in the land records, within a specified time period, if (1) the court orders a lien; or (2) the leasehold tenant or any mortgagee of the property fails to pay the amount of the lien or file a complaint to challenge the lien.

A lien filed under the bill has priority from the date that the ground lease was created.

A lien under the bill may be enforced and foreclosed in the same manner and subject to the same requirements as the foreclosure of a mortgage or deed of trust containing neither a power of sale nor an assent to decree. A foreclosure sale may not be made if the lien is satisfied and costs of giving notice of the sale are paid before the sale.

If the property is sold at a foreclosure sale, the ground lease holder must be paid out of the proceeds of the amount of the lien and the statutory redemption amount. The purchaser takes title to the property free and clear of the ground lease. If the lienholder cannot be located, the lien may be satisfied and the ground rent redeemed in accordance with provisions governing redemption by application to the State Department of Assessments and Taxation (SDAT).

Current Law: When a tenant under a ground lease fails to pay rent, the ground rent holder may bring an action for the past-due rent or for possession of the premises (an ejectment action). In either case, the ground rent holder is limited to three years' past-due rent. Because the tenant has a leasehold estate, a tenant whose property is seized in an ejectment action receives no other compensation. The ground rent holder is then free to release the property under the ground rent or sell the property in fee simple.

For property subject to a ground rent, a landlord may bring an action for possession of the property 45 days after sending a bill for the ground rent by certified mail, return receipt requested, to the tenant's last known address when: (1) at least six months ground rent is in arrears; and (2) the landlord has the right to reenter for nonpayment of the rent. If the tenant cannot be personally served or there is no tenant in actual possession of the property, service may be made by posting notice as prescribed under the Maryland Rules.

Before entry of a judgment, the landlord must also give written notice of the pending entry to each mortgagee of the lease, or any part of the lease, who has recorded a timely request for a notice of judgment in the land records.

Generally, property subject to a judgment for possession is discharged from its ground lease, and the rights of all persons claiming under the lease are foreclosed unless, within six months after the judgment's execution, the tenant or other person claiming under the lease (1) pays the ground rent, arrears, and all costs awarded against that person; and (2) commences a proceeding to obtain relief from the judgment. A mortgagee who is not in

possession at any time within six months after the judgment awarding possession to the landlord may pay all of the landlord's costs and damages and may perform all the covenants and agreements to be performed by the tenant.

A holder of a ground rent that is at least six months past due is also entitled to reimbursement for actual expenses of up to \$500 incurred to collect the past-due amount and comply with notice requirements, including title abstract and examination fees, judgment report fees, photocopying and postage fees, and attorney's fees.

Upon filing an ejectment action, the ground rent holder is entitled to reimbursement for reasonable expenses incurred in the preparation and filing of the action, including filing fees and court costs, costs related to process service or other notice, additional title abstract and examination fees up to \$300, attorney's fees up to \$700, and taxes paid.

In order to be eligible for reimbursement, the holder must give notice to the tenant of the amount of the past due ground rent. The notice must be sent by first class mail to the tenant's last known address as shown in SDAT's records and must state that the holder will take action to repossess the property if the past due ground rent is not paid within 30 days.

A ground rent established on or after April 9, 1884 may be redeemed by the tenant. The tenant must give the ground rent holder one month's notice and pay:

- an amount equal to the annual rent multiplied by:
 - 25, which is capitalization at 4%, if the lease was executed from April 8, 1884 to April 5, 1888;
 - 8.33, which is capitalization at 12%, if the lease was executed after July 1, 1982; or
 - 16.66, which is capitalization at 6%, if the lease was executed at any other time;
- a lesser sum, if specified in the lease; or
- a sum to which the parties may agree at the time of redemption.

If the lease was executed after July 1, 1982, the reversion is redeemable five years after the date of the lease. If the lease was entered before that time, it may be redeemed at any time.

If the tenant is unable to locate the ground rent holder, the ground rent may be redeemed through an alternative method. Under this method, the tenant must submit specified documentation and pay associated fees, along with the redemption amount and three years' back rent, to SDAT.

Background: While ground rents are recognized in other states, Maryland's system is unique. In Maryland, a ground rent creates a leasehold estate in the grantee. The leasehold estate is personal – not real – property. The grantor retains a reversion in the ground rent property and the fee simple title to the land. Ground rents generally have a 99-year term and renew perpetually. Ground rent is paid to the grantor (the ground rent holder) for the use of the property for the term of the lease in annual or semi-annual installments. Under a typical ground rent contract, the tenant agreed to pay all fees, taxes, and other costs associated with ownership of the property.

Ground rents have been a form of property holding in Maryland since colonial times, with some of the earliest known leases dating to 1750. The purpose of these ground rents was to produce income for their grantors. Most ground rents in colonial times required the tenant to erect improvements on the property. Maryland's unique system of ground rents can be traced to wording in its colonial charter from Charles I that prohibited certain feudal tenures, specifically those that would reserve a rent in a grantor who has transferred fee simple title. The 99-year lease was devised to reserve a ground rent without violating Maryland's colonial charter.

Prior to 1884, a ground rent could be redeemable or irredeemable by the terms of the lease. A redeemable ground rent would state the terms under which the tenant could redeem the lease and take fee simple ownership of the property. Generally, a tenant cannot take fee simple ownership of an irredeemable ground rent. When the General Assembly prohibited the creation of irredeemable ground rents beginning April 9, 1884, the General Assembly also established a method of calculating the redemption value.

Chapter 464 of 2003 established an alternative method for redeeming a ground rent if the tenant is unable to locate the ground rent holder, which had become a problem with some of the older ground rents. Under this method, the tenant must submit specified documentation and pay associated fees to SDAT.

In the 20th Century, developers used ground rents as part of their overall business strategy. Properties subject to ground rent could reduce the purchase price to a homebuyer, who might then be better able to afford a mortgage. In the earlier part of the century, a developer would sell houses in a development and retain the ground rent as a steady long-term income source. Later in the century, developers began securitizing and selling the ground rents to finance further developments. Many of these ground rents were held by institutional investors who saw them as long-term, low-risk investments.

When a tenant fails to pay rent, the ground rent holder may bring an action for the past-due rent or for possession of the premises. In either case, the ground rent holder is limited by statute to three years' past-due rent. Because the tenant has a leasehold estate,

a tenant whose property is seized in an ejectment action (an action to retake the premises) receives no other compensation. The ground rent holder is then free to release the property under the ground rent or sell the property in fee simple.

Chapter 80 of 2003 established limits on the amounts that ground rent holders could receive as reimbursement for expenses received for actions to collect past due rent and for an ejectment action. A holder of a ground rent that is at least six months past due is entitled to reimbursement for actual expenses of up to \$500 to collect the past-due amount. In an ejectment action, the ground rent holder is entitled to filing fees and court costs, costs related to process service or other notice, title searches up to \$300, attorney's fees up to \$700, and taxes paid.

Recent newspaper accounts noted a sharp increase in the number of ejectment actions filed in the Circuit Court for Baltimore City during the last five years.

According to estimates from Baltimore City and SDAT, properties subject to ground rents are concentrated mostly in Baltimore City (74,085), with some properties located in Anne Arundel (5,000), Baltimore (35,705), Harford (1,500), Howard (200), Talbot (10), and Worcester (250) counties. SDAT advises that new ground rents have recently been created.

Baltimore City has identified 234,943 separate properties in the city, of which 214,604 have been transferred since 1982. City records indicate that 74,085 of the properties transferred have a ground rent. Of the properties transferred with a ground rent, 67,861 were residential properties with one to four dwelling units.

State Fiscal Effect: Recent newspaper accounts list slightly over 500 occasions since 2000 in which a ground rent holder won an ejectment action. It is unclear whether there would be a greater or lesser number of actions filed relating to liens. It is also unclear whether these actions would be more or less complicated than ejectment actions. However, any overall effect should be minimal.

Local Fiscal Effect: Baltimore City advises that it pays approximately \$36,275 annually in ground rent on 722 properties in a database maintained by its housing department. The city has expressed concern that it may be liable for ground rent on an additional 1,800 properties for which it has not received a bill.

The bill would not materially affect the properties on which Baltimore City is timely paying ground rent. To the extent landlords could bring ejectments action on properties for which the city has not received a bill, Baltimore City could experience minimal

savings on each property. The combined potential savings because of this could be significant.

Additional Information

Prior Introductions: None.

Cross File: HB 463 (Delegate Rosenberg and the Speaker, *et al.*) (By Request – Administration) – Environmental Matters.

Information Source(s): State Department of Assessments and Taxation, Judiciary (Administrative Office of the Courts), Baltimore City, Department of Legislative Services

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